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Institutional Cost Contribution	:	
Requirement for Competitive Products	:	Docket No. RM2017-1

REPLY COMMENTS OF THE GREETING CARD ASSOCIATION

The Greeting Card Association (GCA) files these Reply Comments pursuant to Order No. 3624. In them, we discuss the proposal advanced by United Parcel Service (UPS) for sweeping changes in both the required level of competitive products' contribution to institutional costs and the method of calculating it. As a participant recommending a (much more modest) increase in the competitive share, GCA has extensively considered both subjects[1]. In our view, UPS's proposed methods are unsound and reach an unreasonable result.

UPS proposes to abandon the Commission's approach completely, and to substitute for it one of two procedures, both of which are forms of fully distributed costing. Its preferred approach is to set the minimum share equal to the percentage of attributable costs associated with competitive products.[2] As a second best, it proposes substituting

[1] In proposing an increase in the competitive share to between 10.5 and 11 percent, GCA used an approach the Commission employed in the past: starting from historical results and incorporating an element of conservatism. In Docket R2007-1 (Orders No. 26 and 43), the Commission began with the most recent contribution percentage from products – the 6.9 percent achieved under R2006-1 rates – and scaled it down to 5.5 percent for several reasons which it explained in Order 26 and reaffirmed in Order 43. Because we now have a longer series of contribution level data, GCA adapted this method, taking a simple average of percentages achieved since FY 2010, which turned out to be 10.97 percent.

[2] *Initial Comments of United Parcel Service, Inc. on Notice of Proposed Rulemaking to Evaluate the Institutional Cost Contribution Requirement for Competitive Products* ("UPS Initial Comments"), p. 34.

revenue for attributable cost as a yardstick.[3] These approaches result in proposed contribution levels of 29.4 percent and 24.2 percent, respectively – or 178 percent and 147 percent of the most recent, and highest ever, actual level (16.5 percent).[4]

GCA believes that the minimum share requirement, however arrived at, should first of all be achievable. One based on historic results, with a conservative tilt, is probably the likeliest to pass this test. One far exceeding any historically achieved result seems almost certain not to. In this connection, GCA, like a number of other commenters, believes that the Commission must take care to avoid forcing the Service into traffic-killing price increases.

A competitive share based on an a priori pricing rule – one which is usually thought to produce inefficient prices and which the Commission has repeatedly criticized[5] – is also not a good candidate to produce an achievable minimum share. UPS's two proposed methods both fall into this category. As versions of fully distributed costing, both are essentially pricing techniques. This is relevant because in Order 26 the Commission rejected the pricing-rule approach to setting the competitive share:

> . . . Among the options considered and rejected were: equal unit contribution, equal percentage markup, markup of competitive products' attributable costs, and percentage of revenues. None of these was deemed preferable to the alternative of basing competitive products' contribution on a percentage of total institutional costs. To be sure, the various other methods could all be expressed mathematically in terms of total institutional costs, but each implies a pricing technique, *e.g.,* a particular coverage level, absent from simply basing appropriate share on a percentage of total institutional costs.[[6]]

The Commission was right to reject these techniques, most obviously because the minimum share is not a price. The Commission explained clearly in Order 26 (¶ 3056) that

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[3] Id., p. 39. For both methods, UPS recommends using a three-year moving average.

[4] Because the Former Utility Regulators, in their *Comments,* do not advocate a specific share level, we do not address those comments separately. However, they could usefully be reviewed in light of the methodological observations we offer here with respect to the UPS proposals.

[5] See, e.g., PRC Op. R84-1, ¶¶ 3020 et seq.; PRC Op. R87-1, ¶ 3025, fn. 8.

[6] Order 26, ¶ 3050.

the minimum share, far from being a price, is a floor which the Postal Service, exercising its broad discretion as to competitive prices, is encouraged to exceed. Consequently, using a pricing technique to set it is a fundamental methodological error.

The same error also affects UPS's discussion of European Commission practice.[7] UPS states that "[p]ostal regulators in the EU and in the U.S. face similar problems in allocating fixed costs between competitive and reserved/market-dominant products."[8] This may or may not be the case, but it remains true that in setting a minimum contribution share for competitive products, the Commission is not allocating fixed costs between (sets of) products.[9] To *allocate* these costs, as UPS represents the European Commission as doing, is to set a fixed quantum for each product category to recover, and, in the next step, to derive prices from those costing determinations. That is just what the Commission said, in Order 26, that it was *not* doing. For the regulator to set a floor which, in the same Order, it says it hopes the regulated enterprise will exceed is not cost allocation.

Consequently, GCA respectfully urges the Commission to reject the UPS proposals.

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[7] UPS Initial Comments, pp. 37 et seq.

[8] Id., p. 38.

[9] The Commission does, in a trivial sense, "allocate" fixed costs to competitive products when it enforces the requirement that each competitive product cover its attributable cost; this process insures that no such product is "allocated" a negative quantum of institutional cost. But that "allocation" is required by sec. 3633(a)(2), and is not what the Commission is directed to do under sec. 3633(a)(3) or 3633(b).